Association of Bay Area Governments
Bay Area Air Quality Management District
Metropolitan Transportation Commission

Joseph P. Bort MetroCenter
101 Eighth Street
P.O. Box 2050
Oakland, CA 94607-4756
(510) 464-7942
fax: (510) 433-5542
tedd@abag.ca.gov
abag.ca.gov/jointpolicy/

Joint Policy Committee / Regional Planning Program

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To: Joint Policy Committee

From: Regional Planning Program Director

Subject: Smart-Growth Incentives for Local Government

The Joint Policy Committee has requested information on smart-growth incentives. This memo lays out a simple framework for organizing and understanding existing and potential incentives and then identifies incentives applicable to local governments only. The current status of various local-government incentive ideas and programs is described and a recommendation is made to consider a regional program to facilitate local-government access to those incentives that are available. Subsequent memos will detail incentives that may be provided to the other significant actors in the development process—in particular, developer/investors and local neighborhoods.

Many of the ideas in this the memo are compiled from work done for the *Smart Growth Strategy / Regional Livability Footprint Project* and from a database I am compiling of smart-growth resources. The *Strategy/Project*, of course, had the benefit of extensive public and local-government involvement.

1. An Incentive Framework

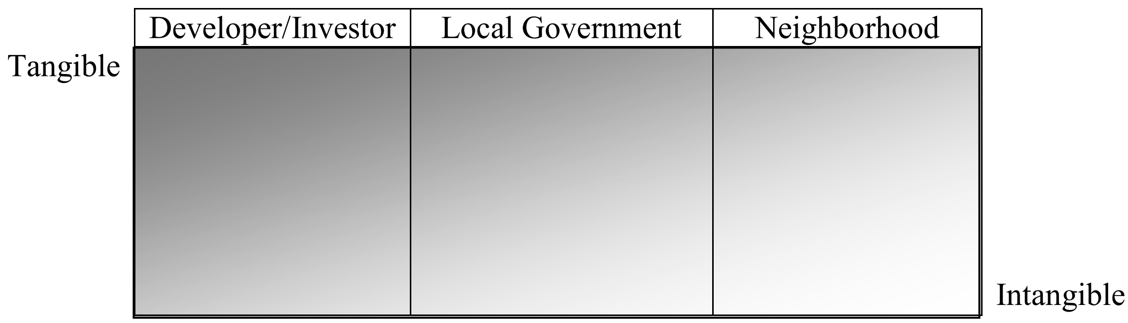
Incentive: a thing that motivates or encourages someone to action or increased effort (Compact Oxford English Dictionary).

Incentives can be arrayed along a continuum from *tangible*, very real and definite, to *intangible*, more vague and abstract. A tangible incentive might be something like a direct cash grant tied to the achievement of a specific development objective (say, a prescribed number of housing units at a particular density and/or affordability level). An intangible incentive could consist of simple recognition for a job well done (say, publication in a best practices manual or a plaque presented at an awards ceremony). Lying somewhere between the extremes of the continuum would be an incentive like risk reduction (for example, providing lower-cost insurance to cover the unknowns of site remediation) or technical assistance (helping development proponents through unfamiliar territory). Tangible incentives are generally easily valued in financial or economic terms; a dollar number can usually be attached. The value of intangible incentives is generally less clear or less certain. Tangible incentives most often go directly to the bottom line; intangible incentives may take a more circuitous route.

Incentives can also be scaled both positively and negatively relative to a zero baseline, at which actors may be indifferent to particular types or intensities of development. Moving decision makers to the base line, and beyond to action, may require the removal of negative *disincentives* as well the provision of positive incentives.

Three separable actors may require incentives. First are the developers and investors who need to commit to and construct specific projects. Second are the cities and counties that must plan for and encourage particular kinds of development. Third are the local communities or neighborhoods that are required to accept change, generally in the form of increased densities and associated impacts. All three actors are motivated by a range of tangible and intangible incentives, though tangible incentives may generally be more important to developers and investors and intangibles may play a greater role for neighborhoods. In their mediating role, local governments may be subject to the greatest range of tangibles <u>and</u> intangibles. As well, local governments may occasionally act as developers and investors, making them sensitive to at least two separate incentive arrays.

The distribution of incentive emphasis among the three actors in the development process is graphically illustrated in the chart below. The more tangible the required incentives, the darker the shading.



2. <u>Incentives to Local Governments</u>

The State of California has by far the biggest existing and potential role to play in providing smart-growth incentives to local governments. The Federal Government can also be powerful, mostly through grants-in-aid. Regional agencies, constrained in both resources and statutory authority, have a less central role to play, but can be influential at the margins, through the development and advocacy of incentive policy, and through the brokering of incentive packages.

Existing and potential smart-growth incentives applicable to local government are described below in rough descending order of tangibility.

2.1. Local Government Tax Revenue—Removing or Reducing Fiscal Disincentives

In the State of California, one of the largest impediments to local governments' embracing of smart growth is thought to be the structure of local-government finance. Proposition 13 and the subsequent Proposition 218 have reduced the role of property-based taxation as a local-government revenue source and have increased reliance on other sources, particularly local sales taxes. This is believed to have caused counties and cities to favor sales-tax generating commercial uses over property-tax-bound residential uses. Housing is widely perceived to generate more costs in municipal services than it generates in taxes, while retail uses are seen to be net generators of local-government revenue—albeit volatile. Other revenue demands, particularly education, have also crowded the property-tax base, making it less available for local government purposes and reducing local motivation to improve the base.

Recent and on-going efforts at local-government fiscal reform have concentrated more on increasing the size and stability of local revenue sources and less on reducing the unintended land-use perversities resulting from the convoluted tax structure. A popular current idea is to split the commercial property base from the residential base, stripping the commercial base of the constraints imposed by Proposition 13—particularly those limiting significant assessment increases to properties which have been transferred. Tax assessments on commercial property would then be allowed to float upward with market valuations and would no longer be sheltered by nominally unchanging corporate ownership. This reform is positive from the standpoint of enhancing one part of the property tax base; and it may initially favor older, inner communities where long-standing, sheltered commercial and industrial uses are more dominant. However, over the long-term, differentially increasing the commercial base while leaving the residential base relatively unchanged may further bias local land-use preferences toward new commercial uses and away from housing. Tax-base splitting is clearly worth doing, but with care and with an eye on further improvements in the future.

More positive, stable and predictable land-use incentives would be provided by moving the entire property-tax base (residential, commercial and industrial) closer to current and real market valuations. However, while rational and quite practical, this is generally regarded to be politically unrealistic.

Regional tax-base sharing, such as occurs in the Minneapolis-St. Paul metropolitan area, has also been suggested as a way of neutralizing some of the perverse incentives that occur under the current local-government fiscal regime. The theory goes something like this: if local governments had to share a fixed proportion of the revenue they derived from new commercial and industrial uses, they would be proportionally less inclined to seek these uses in preference to other more socially desirable ones. As well, older, otherwise declining areas would be somewhat cushioned from the fiscal impact of businesses relocating. However, while theoretically compelling, the practical realities of calibrating a tax-sharing arrangement are daunting: its effectiveness varies both with the magnitude of the share and with the number of localities participating in the sharing arrangement. Implementation over the nine counties and 101 cities of the Bay Area would be a major undertaking.

A California version of regional tax-base sharing with a unique incentive twist was introduced during the 2001-2002 Legislature. AB 680 (Steinberg) would have had a proportion of sales and property tax revenues diverted from municipalities that did not meet their mandated housing obligations. Diverted revenues would be provided to the regional planning agency and effectively shared across the region by being used for regional purposes. The bill, which failed to pass, would have only applied to the Sacramento metropolitan area.

Another uniquely California variant on tax-base sharing would see localities swap a proportion of their sales tax revenues for an equal portion of property tax revenues currently flowing to the State. This is argued to provide cities and counties with a more stable revenue source and to reduce the incentive to favor retail commercial uses over housing. AB 1221 (Steinberg and

Campbell) proposed this scheme, but failed to achieve passage in the 2003-2004 session of the Legislature.

2.2. Tax Increment Financing

Tax increment financing (TIF) was invented in California in 1952 and has been widely used across North America as a mechanism to pay for redevelopment expenditures—most commonly public capital infrastructure, but occasionally other investments deemed to be socially beneficial.

In its traditional California use, TIF is applied to the improvement of "blighted" areas. Currently before the California legislature is SB 521 (Torlakson). This bill would define "blight" to include the lack of high-density in a transit village area and, therefore, would permit the use of TIF to assist transit-oriented development. The bill has been described as TIF for TOD. Unfortunately, the use of "blight" as a rationale for TIF raises all sorts of negative connotations and fears for affected communities—including the possibility of eminent domain. A more positive criterion for the application of TIF may be preferable.

The TIF concept is simple. Municipalities designate an area for improvement and then earmark a portion of the future growth in tax revenues derived from that area to pay down the municipal debt incurred in facilitating redevelopment. For TIF to work, the tax base in the redevelopment area must increase proportionately more than the tax base for the municipality as a whole. If it does not, then there may not be enough revenue to pay down the debt, or tax revenue will be diverted unintentionally from other municipal and non-municipal uses (for example, education) for redevelopment purposes. If the development is successful in increasing tax base, then, once the debt is paid off, the increment is gravy and can be applied both inside and outside the area for general public uses.

An important question for the smart-growth strategy is the appropriateness of TIF to facilitate land recycling and infill development in other areas that are not genuinely blighted or part of a transit-oriented development. AB 1203 (Mullin) appears to take a step in this direction. It proposes to authorize local governments to create "greyfield housing investment zones" in order to pursue regional redevelopment priorities. The zones would have access to TIF, transportation and infrastructure funds and affordable housing funds.

2.3 Grants-in-aid

Governmental categorical grants-in-aid are not as plentiful as they once were, and only a few are targeted, directly or indirectly, toward smart-growth objectives.

The most comprehensive smart-growth-related grant programs appear to be those directed at brownfield redevelopment (i.e., the cleanup and reuse of contaminated sites). Grants can often be parlayed with government-sponsored loans, loan guarantees, insurance, and technical assistance programs. Both the state (through CEPA) and the federal government (principally through the EPA) are active in this field, though needs seem to generally exceed available resources. The Association of Metropolitan Planning Organizations (AMPO), of which MTC is a member, has published a guide on using federal transportation funds to assist brownfield remediation.

The federal government, through the Department of Defense (DOD), also provides some grant money to assist communities in planning the reuse of closed military bases. To the extent that funds are available, this program may be applicable to several localities in the Bay Area.

Other grant programs that can be directed at municipal smart-growth initiatives are available through the Environmental Protection Agency (EPA), the Department of Commerce (DOC), the Department of Housing and Urban Development (HUD), and the Department of Transportation (DOT). At the state level, local-government grants are available through a number of agencies, including Caltrans, CEPA, and Housing and Community Development (HCD). While applicable to smart-growth initiatives, the nominal objectives of these grants program vary widely: from global atmospheric change, to community economic development, to affordable housing, to congestion management.

Many communities, of course, employ grants specialists—either in house or as consultants—to help identify and apply for grants applicable to their specific situation. There is at least one subscription-funded internet site, the sole purpose of which is to assist local governments in navigating the grants landscape, finding and interpreting categorical programs to fit their needs.

And the grants landscape for local governments is not solely populated by federal and state governments. Local-government grants are also occasionally available from private foundations (for example, Hewitt, Haas and Irvine), from trade-based associations (such as the Urban Land Institute) and even private corporations (the Bank of America). Most of these assist unique planning studies and demonstration projects.

As the JPC's smart-growth implementation program grows, one legitimate and worthwhile use of regional resources may be assisting local governments in identifying and accessing appropriate grant money from the confusing variety of possible sources.

Of special interest in the Bay Area are grant programs administered by BAAQMD and MTC.

BAAQMD's Transportation Fund for Clean Air (TFCA) is mostly to help finance local investments in transportation capital that contribute to less pollution. However, there are creative applications of these capital investments which may contribute to smart growth. For example TFCA monies were used to improve pedestrian and bicycle linkages in the Fruitvale Transit Village area, contributing to the overall success of that smart-growth project. In the current fiscal environment, moving projects forward requires combining funds from several sources, and the TFCA was one of many grant programs used in creative combination to advance the Fruitvale project.

MTC's program is Transportation for Livable Communities (TLC). MTC gives small local-government grants for community design and planning and for capital projects. Part of the TLC initiative is the Housing Incentive Program (HIP). HIP uses transportation funding to reward communities that promote high-density and affordable housing, as well as mixed uses, in association with transit.

TLC supports community-based transportation projects that:

- Are developed through a collaborative and inclusive planning process that includes broad partnerships among a variety of stakeholders;

- Improve the range of transportation choices by adding or enhancing pedestrian, transit and/or bicycle facilities, and by strengthening the links between these facilities and between these facilities and major activity nodes;

- Support well-designed, high-density housing and mixed use development that is well-served by transit, or will help build the capacity for future transit investment and use;

- Support a community's infill or transit-oriented development and neighborhood revitalization activities;

- Enhance a community's sense of place and quality of life.

A brochure describing the MTC TLC program and its application in a variety of applications across the region is included with this memo (for JPC members only—additional copies available through the MTC/ABAG library).

A special application of TLC grants, currently under consideration by MTC and the JPC, will be to fund station-area plans. Initially these planning grants are proposed to go to localities scheduled to be affected by Resolution 3434 projects. Over the longer-term, they could be applied to existing station areas pursuing in-fill development.

County congestion management agencies (CMAs) also use funding provided through MTC (the T-plus program) to support local smart-growth initiatives. CMAs provide their own TLC and HIP programs, in addition to those which occur directly through MTC.

Across the country, a few other Metropolitan Planning Organizations (MPOs) have launched programs similar to TLC. The Atlanta Regional Council (ARC), for example, has a Livable Centers Initiative (LCI) and the Minneapolis-St. Paul Metropolitan Council has a Livable Communities Demonstration Program and a Local Housing Incentive Program. A number of MPOs use Federal TEA-21 Transportation Enhancement money to support local community-development initiatives in association with transportation improvements. However, we know of no program as ambitious and as comprehensive as TLC in the Bay Area.

2.4 Loans and Financing Assistance

While obviously not as attractive as a grant, the availability of loan money at reasonable rates can assist counties and cities in undertaking smart-growth projects which they could not otherwise afford or which would not proceed in a timely manner were they to be funded on a pay-as-you-go basis.

SB 223 (Torlakson) proposes a revolving loan program to fund specific plans. Loans would be repaid by development fees and be forgivable in certain unspecified cases. Specific plans can be highly valuable in assisting cities and counties achieve higher density and mixed-use communities that are neighborly, work well in association with transportation and other local infrastructure, and are livable. In addition, specific plans permit the preparation of a master Environmental Impact Report (EIR) that can expedite development by streamlining CEQA review. Specific plans and master EIRs comprise the cornerstone of the JPC's initial legislative program. A possible weakness in the currently proposed bill is that it contains no source of revenue to fund the initial loan pool or to forgive some loans, as it proposes to do.

Municipal infrastructure projects associated with community redevelopment can receive loans from a revolving fund administered by the California Infrastructure and Economic Development Bank (CIEDB or I-Bank). Loans are awarded on a competitive basis with projects ranked using a criteria scoring system. The criteria include reference to smart-growth principles.

There are also various federal, state, and non-governmental loan programs to assist with the remediation of brownfields. One nascent program in this area is administered by the California Center for Land Recycling. While most applicable to small community non-profits, the program has also been employed by cities and towns.

AB 350 (Mathews) would authorize the creation of infrastructure financing districts in inter-regional job-housing opportunity zones in order to stimulate economic development in housing-rich, job-poor areas. The obligations incurred in these districts would be repayable through tax increments.

Although not specifically targeted to smart growth, municipalities may also access ABAG financial services, including credit pooling, to finance infrastructure and redevelopment capital.

2.5 Senior Government Public Investment

The principle of prioritizing state infrastructure investments to support compact development and other smart growth initiatives was pioneered by Maryland in 1997. The Priority Funding Areas Act directs the State to focus growth-related infrastructure funds so as to support established communities and locally designated growth areas and to protect rural areas. Assessments of the Act's effectiveness in promoting intended growth are as yet inconclusive.

In 2002, California's AB 857 (Wiggins) became law. AB 857 deals with state infrastructure planning, priorities and funding. The bill establishes principles to guide the state's five-year infrastructure plan and its comprehensive Environmental Goals and Policy Report. Those principles give priority to infill development and redevelopment, cultural and historic resources, environmental and agricultural resources, and efficient development patterns. The state administration has yet to publish the Environmental Goals and Policies which would give these principles effect.

MTC's draft TOD policy uses the promise of regional transportation investments as an incentive for more compact development adjacent to transit. The proposed policy applies mostly to Resolution 3434 transit expansions, many of which might otherwise be sprawl-inducing or uneconomic. In the future, MTC may wish to consider how transportation investments can also be used to support and reward in-fill and density initiatives in more mature, established communities. This could be an area of intense interaction between the smart-growth strategy and the next regional transportation plan (RTP).

A public infrastructure area to watch relative to smart-growth incentives is the emerging "small schools" movement. One of the principal defining characteristics of a smart traditional or neo-traditional neighborhood is the neighborhood school, and the small schools movement is attempting to push public policy back to that model—mostly for educational reasons but with significant implications for how our communities are structured.

2.6 Relief from Statutory Obligations

Compliance with state and federal regulations can be expensive and time-consuming for developers and local governments alike. It can also introduce an element of uncertainty into the development process that increases risk for all parties. The poster child for expense, time and uncertainty in this state is the California Environmental Quality Act (CEQA). Before even addressing possible mitigation, the process of compiling information and analysis is thought to make some redevelopments uneconomic or too risky to pursue. There is little appetite for abandoning the fundamental purposes of CEQA, but there is increasing discussion aimed at improving the process. Some initiatives provide CEQA relief when there is a presumed higher social or environmental purpose.

SB 1925 (Sher), signed into law in 2002, provided CEQA exemptions for a small class of affordable housing and infill development, particularly in the City of Oakland. SB 832 (Perata, Lowenthal, and Torlakson), introduced to the current sitting of the Legislature, expands CEQA exemptions to in-fill projects of up to ten acres and 300 residential units, but only in cities of 200,000 or more in population. Four Bay Area cities—San Jose, San Francisco, Oakland, and Fremont—would qualify.

2.7 Risk Management

The management of risk is a huge incentive area for developers and investors, particularly as it relates to the possibility of litigation; and we will explore this in a future memo.

With the advent of insurance pools, such as ABAG's PLAN, and more conscious municipal risk-management strategies, liability risk has become less of a concern to "deep-pocket" local governments.

The principal municipal risk concerns relating to smart growth center on brownfield redevelopment. If land owners (including local governments) discover contamination as part of a site investigation process, they may be held accountable for expensive remediation even if they decide not to proceed with redevelopment. This discourages some localities from beginning a redevelopment investigation. To partially deal with these concerns, California, along with other states and the Federal Government, have developed a number of risk mitigation instruments. These include some statutory limitations on liability, partial indemnifications, and pooled insurance schemes.

There is some argument about the sufficiency of these measures, and they are just obscure and arcane enough to make it difficult for local actors to determine what applies to their situation and what does not. In the municipal sector, when there is the confusion and uncertainty, the most likely action is no action. One possible regional role in the pursuit of smart growth could be assisting cities and counties in sorting through the complex risks and risk-management options associated with the reuse of potentially contaminated sites and assisting localities in accessing appropriate resources.

2.8 Technical Assistance

Environmental risk management is but one of several specialized technical activities that might be efficiently provided or brokered by a regional agency on behalf of local governments pursuing the smart-growth cause. Some technical areas are so rarified that many municipalities would have trouble even figuring out what sort of consultants to hire. It would be impractical and uneconomic to provide for some technical areas of expertise within the typical local government house, but it may be possible and beneficial to pool resources at the regional level.

A model for this, not directly related to smart growth, is ABAG's program on seismic hazard mitigation. For smart growth, experts might be provided by or contracted through a regional agency to deal with the many specialized aspects of station-area planning, to assist in representing and evaluating the impacts of various density scenarios, or to assess comparables so communities could evaluate the probable property-value effects of neighborhood change. The provision of model codes and ordinances may also be helpful. There are many more possible examples that the region could pursue in an effort to assist and thereby encourage localities to pursue smarter development. However, neither adequate financial resources nor many appropriately specialized experts exist in regional agencies at this time.

A possible first step along this path, acknowledging the very severe regional resource issue, would be for the region to more assertively assist networking among local governments. Cities and counties confronting similar smart growth issues could clearly learn from one another.

2.9 Awards and Recognition

MTC currently gives awards for various transportation achievements, and a number of regions around the country provide recognition for exemplary projects or leading-edge local development practices. These intangibles are probably more effective in spreading the good word than in motivating difficult local planning behavior, but they are relatively inexpensive and arguably worth doing just for the additional public, political, and professional attention they could bring to the smart-growth idea. In a region that continually bemoans its planning inadequacies, there is some merit in publicly celebrating smart-growth successes when they occur. Positive change often occurs through emulation, and it may be very helpful to recognize some high-profile examples that others can follow and then improve upon.

2.10 Intrinsic Rewards

Finally, it is really important to explicitly acknowledge that smart growth is any many ways its own incentive. The kind of development contemplated in the Bay Area smart-growth vision will help make our cities and towns more diverse and more interesting. It will provide an enhanced local market for shopping, dining, entertainment and recreational amenities and thus contribute to both sales and property tax growth. It will put eyes on the street that make our communities safer, potentially decreasing requirements for additional police. By concentrating development on the cooler Bay plain, it may reduce energy demands and help conserve water, moderating demand for new utility infrastructure. By encouraging walking and biking, it should help combat obesity and increase public health; and by protecting natural assets it will contribute to a better, more manageable environment. Smart growth will give people increased opportunity to choose to reduce their commute, potentially increasing the time they can spend with their families, in voluntary activities or in civic engagement. This could generate payoffs for child development, education, social services and quality government.

While tangible and direct monetary incentives may be required to kick start smart growth, ultimately it may be more intangible benefits like those listed above that will sustain that growth and make it the new norm. Of course, we need to be careful not to oversell smart growth; not because the benefits cannot be real, but because they will take a great deal of effort and a very long time to achieve in a large, heavily developed region like the Bay Area. While not instant utopia, smart growth describes the qualities which people have traditionally valued in their communities and which exemplary local governments have consistently tried to achieve. By facilitating better communities and better government, it can be a genuine return to the future.

3. Conclusion

There are a great many tangible and intangible incentives that can be applied to encourage local governments in their smart-growth endeavors. Fiscal resources to support the more tangible incentives will continue to be a big issue for the foreseeable future. One of the most useful roles regional agencies can play in this fiscally constrained environment is the conceptual and programmatic packaging of various incentives to make them more accessible and useful to local governments. MTC's TLC and T-plus programs demonstrate the utility of this approach, although at an admittedly restricted scale. Similar creativity, applied beyond the limited use of state and federal transportation funds, may be of substantial assistance to local governments.

4. Recommendation

Regional planning resources at all three of the JPC's member agencies are finite, fully occupied and not currently available to undertake any of the creative incentive work suggested in this memo. However, as a requirement of SB 849 and at the request of the Joint Policy Committee, ABAG, BAAQMD and MTC are currently considering ways in which limited agency resources can be reconfigured to support the implementation and refinement of the smart-growth strategy.

A report back to the JPC and then to each of the member Boards and Commission is required before the end of the year.

I RECOMMEND:

THAT the JPC request that, as part of their joint planning resource review, ABAG, BAAQMD and MTC address the possibility of providing a centralized facility to assist Bay Area local governments in identifying, packaging and accessing the smart-growth incentives currently and potentially available from a variety of sources.